



# County of Los Angeles CHIEF ADMINISTRATIVE OFFICE

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January 25, 2007

To: Supervisor Zev Yaroslavsky, Chairman  
Supervisor Gloria Molina  
Supervisor Yvonne B. Burke  
Supervisor Don Knabe  
Supervisor Michael D. Antonovich

From: David E. Janssen,  
Chief Administrative Officer

## SACRAMENTO UPDATE

### State Budget Hearing

On Wednesday January 24, 2007, the Senate Committee on Budget and Fiscal Review, chaired by Senator Denise Ducheny, held a hearing to include testimony by the Department of Finance (DOF) and the Legislative Analyst.

Senator Ducheny opened the hearing with the observation that the Governor's Proposed Budget provided a more reasonable starting point than past budgets, and that she was ready to begin work on developing a final budget. She also applauded the fact that the budget provided the full cost-of-living-adjustment (COLA) for the aged, blind and disabled receiving SSI/SSP. However, she noted that there were a number of issues, such as the proposed CalWORKs cuts that were problematic.

Vince Brown, Chief Deputy Director for Budgets from DOF, provided an overview of the Governor's Proposed Budget that was similar to the presentations by the Governor and DOF on January 10, 2007. He stressed that the budget was balanced, had no new taxes, did not rely on the issuance of any additional deficit reduction bonds and, in fact, provided for an earlier payoff of \$1.6 billion of the outstanding deficit reduction bonds. Mr. Brown also made the point of defending the Administration's revenue forecasts included in the Governor's Proposed Budget asserting that DOF based their projections on more recent revenue information from the Franchise Tax Board (FTB) than that available to the Legislative Analyst's Office's (LAO) in the November revenue forecast.

The Legislative Analyst, Elizabeth Hill, testified that her goal was to give the Committee a picture of how the "big pieces of the Budget fit together." She also made a point of clarifying for the Committee that her January 12, 2007 assessment of the Governor's Proposed Budget did include the most recent revenue data from FTB, updated from their November forecast.

Overall, Ms. Hill said that she did not share the Administration's optimism regarding the strength of the Proposed Budget and saw significant downside risks. She indicated that these risks could be grouped into three categories: baseline risks; solution risks; and legal risks.

Baseline Risks. Ms. Hill described baseline risks as the assumptions, primarily about revenue growth, used to estimate the FY 2007-08 Budget needs absent any changes in law. She said that General Fund revenues through January were \$650 million below estimates. This could suggest that there could be a downward adjustment in revenues in the May Revision. She also said that the assumption of 10 percent growth in property tax revenues seemed "aggressive", and that her assessment of the softening real estate market suggests a lower growth rate that equates to \$200 million less property tax revenues.

Solution Risks. The LAO cited the proposal to include \$506 million in new revenues from the tribal gaming compacts in the Proposed Budget. Aside from any uncertainty about whether the Legislature will pass legislation ratifying the compacts, which were rejected by the Legislature last year, Ms. Hill said that it was unlikely that all of the 22,500 new gaming devices included in the compacts could be brought on line by July 2007. Thus the LAO estimates that Indian gaming revenues to the General Fund in the Budget are overstated by \$300 million. In addition, the LAO suggested that there are significant risks associated with the proposal to use \$1.1 billion from the Public Transportation Account (PTA) to replace General Fund spending for: 1) Proposition 98 funding for home-to-school transportation; 2) transportation services provided by regional centers; and 3) debt service on general obligation bonds issued for transportation projects. Ms. Hill believes that the Budget estimate of the growth in PTA revenues is too high, and that as little as a five percent error would eliminate the revenues for the three new programs proposed to be funded from the PTA. There are also potential legal risks with the proposed new uses for PTA funds that are discussed below.

Legal Risks. The State budget faces a fiscal pressure due to questions regarding the legality of a transfer of \$627 million in PTA funds to the Proposition 98 account to support home to school transportation and thereby reducing the General Fund obligation to K-12 schools. Additionally, the LAO questions the validity of the Proposed Budget assumption of \$527 million in new revenue from the sale of pension obligation bonds (POBs). So far, the issuance of these bonds has been halted by a court ruling

that the POBs require a vote of the people. The LAO does not believe a reversal of this ruling is likely. Even if it the courts were to rule in the State's favor, she stated that the issuance of these bonds reflect a poor policy choice because, the Budget would be using scarce General Fund resources through the substitution of relatively high-interest POBs with an early pay-off of low-interest deficit reduction bonds. The last legal risk cited is the *Guillen* court case where an appellate court decision is likely next month. The Superior Court held in *Guillen* that the suspension of the October 2003 CalWORKs COLA was improper. The LAO believes that the Administration is overly optimistic in assuming a reversal. Absent a reversal, the State faces one-time CalWORKs grant costs of \$435 million, plus ongoing costs of about \$115 million. Neither of these costs are included in the Governor's Proposed Budget.

Finally, Ms. Hill told the Committee that the LAO Analysis of the Budget and the Perspectives and Issues would be released February 21, 2007.

We will continue to keep you informed as developments occur.

DEJ:GK  
MAL:DW:SK:hg

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